



Property Casualty Insurers
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STATEMENT

PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI)

H.B. No. 6444 – AN ACT CONCERNING AUTOMOBILE INSURANCE

COMMITTEE ON INSURANCE AND REAL ESTATE

February 17, 2009

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to comment on H.B. 6444. Our comments are provided on behalf of the member companies of PCI, a national property casualty trade association with over 1,000 member companies. PCI member companies provide almost 50 percent of Connecticut's personal auto coverage.

This bill would prohibit the use of credit ratings to set private passenger automobile insurance premiums and would adjust the weight given territorial loss cost data in setting territorial rate classifications for individual automobile insurance rates. Under the current "75-25" rule in place in the state, 75 percent of the rates for any territory are based on the claims experience in that territory and 25 percent are based on the statewide average claims experience. H.B. 6444 would adjust this formula to a "50-50" split in 10 steps by January 1, 2019.

PCI strongly opposes the bill and both of these provisions based on very similar points:

- Both practices – the use of credit scoring and geographical location as risk classification and rating criteria – are actuarially sound and objective methods for improving the relationship between the insurance risk and the related price, so that those with a higher risk exposure pay more and those with a lower risk exposure pay less.
- Studies have confirmed that there is a correlation between credit history and the risk of insured loss and it has long been recognized that the geographical location of a driver's residence is among the most effective variables for determining auto insurance loss expectancy.
- Eliminating the use of credit scores and limiting the use of territorial rating distorts the competitive efficiency of the insurance marketplace where higher-risk consumers – those with lower credit scores and those who live in urban areas – should pay higher premiums, and where lower-risk consumers – those with higher credit scores and those in non-urban areas – should pay lower premiums.
- As a result, the bill would redistribute costs by forcing some consumers to subsidize the premiums of other consumers. Consumers with higher credit scores who pose less of a risk will have to pay higher premiums; consumers with lower credit scores who pose a greater risk will see their premium costs reduced. Similarly, under the current "75-25" rule, lower-risk drivers in non-urban areas have had to pay inflated and unfair rates to subsidize those drivers living in higher-risk urban areas who already pay lower prices than what their levels of risk reflect. If the state adjusts the mix to a "50-50" split, the problem would be compounded as lower-risk drivers would pay an increased subsidy to the benefit of drivers in higher-risk areas.
- No state in the country requires that insurance prices be set using a mandated distribution of territorial and state losses. Only three states prohibit the use of credit information in the setting of personal automobile insurance premiums.

CREDIT SCORING

PCI strongly opposes the provision in H.B. 6444, which would prohibit the use of credit ratings to set private passenger automobile insurance premiums. Such a ban is unnecessary due to the protections afforded under current regulations, ignores the fact that every major objective study of the practice has concluded that there is a strong and direct correlation between credit history and the risk of insured loss and, most importantly, while individuals with poor credit ratings would benefit, the bill would result in far more Connecticut consumers seeing an increase in their auto insurance premiums.

Connecticut's Insurance Department has already established one of the more stringent regulatory schemes in the country regarding the use of credit information. Under the Department's guidelines financial history management programs used to underwrite risks must be filed with the Department and must include documentation demonstrating the correlation between the program and the expected risk of loss and how the program impacts consumers in urban versus non-urban territories. We are aware of no evidence of abuse in the use of credit scoring as an underwriting tool.

In addition, the departmental guidelines impose significant restrictions on the use of this information, particularly the directive that **credit scoring can only be used for underwriting new business** and may not be the sole reason for a denial of coverage. In addition, certain credit characteristics, such as the consumer's lack of a credit history, number of credit inquiries, and total available line of credit cannot be used.

In fact, when the Department published these guidelines it stated that: "As a result of a lengthy examination of financial history measurement programs and the experience of such programs in other states, we conclude that they will benefit Connecticut consumers. Certain consumers will benefit through lower insurance rates. Other consumers who have had significant credit events such as bankruptcy or foreclosure should find coverage more available. Connecticut consumers will be protected by guidelines that are unique to Connecticut."

The Connecticut Department's conclusions are consistent with the findings of the numerous objective studies that have explored the relationship between credit history and the risk of insured loss. In general, these studies have found that there is a positive relationship between one's credit history and insurance claiming behavior as people who are worse credit risks tend to file more claims than people who are better risks.

Perhaps most importantly, the federal government's study, conducted by the Federal Trade Commission (FTC) in 2007, concluded that: "Credit-based insurance scores are effective predictors of risk under automobile policies. They are predictive of the number of claims consumers file and the total cost of those claims."

The FTC study confirmed the conclusions of other earlier studies that found that there is a correlation between a consumer's credit-based insurance score and that consumer's propensity for auto insurance loss. A 2003 study by EPIC Actuaries (now part of Tillinghast), the largest and most comprehensive study ever undertaken on the connection between credit history and insurance risk, found that individuals with the lowest insurance scores were found to incur 33 percent higher losses than average, while those with the highest scores incurred 19 percent lower losses than average. Studies conducted by the University of Texas in 2003, funded by the State Legislature, and the Texas Department of Insurance in 2005 reached the same conclusion as well. The Texas Department's study found that the average loss for people with the worst credit history is double that of people with the best credit. Drivers with the best credit are involved in 40 percent fewer accidents than those with the worst credit.

These studies confirm what insurers know from data and experience – that credit-based insurance scoring is an objective and accurate method for assessing the likelihood of insurance losses. Insurers that consider credit information in their underwriting and pricing decisions do so for only one reason – insurance scoring allows them to rate and price business with a greater degree of accuracy and certainty. And the more accurate and certain insurers can rate and price business, the greater the benefit to the majority of consumers.

After concluding that there was a correlation between credit scores and insurance risk, the FTC study detailed the benefits enjoyed by consumers when insurers can more accurately predict losses: “For example scores permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would otherwise not be able to determine an appropriate premium. Scores may also make the process of granting and pricing insurance quicker and cheaper, cost savings that may be passed on to consumers in the form of lower premiums.”

And in a competitive environment where there are fewer restrictions on the ability to use insurance scores, more companies are likely to enter or stay in certain markets or write special risks. A growing number of carriers providing a wider array from which to select can only moderate costs and benefit consumers.

More importantly, as the FTC study points out, since credit scoring is an effective predictor of the number of claims consumers file and the total cost of those claims, “The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer. Thus, on average, higher-risk consumers will pay higher premiums and lower-risk consumers will pay lower premiums.”

And here we get to the true cost of this legislation and the burden it would impose on consumers, more of whom have good credit scores that currently afford them better insurance rates, than what they would receive if credit histories were not permitted. By prohibiting the use of this risk assessment factor, H.B. 6444 would impair the competitive efficiency of the insurance marketplace. **By eliminating a tool that enables insurers to better match the price of insurance to the risk of loss, the bill would result in a cost shift that penalizes consumers with good credit.** While they are less likely to incur insurance losses, they would see their premiums increase as they would no longer derive the benefit that accrues from a good credit score. And in a true distortion of insurance pricing, consumers who are more likely to suffer a loss would see their premiums decrease as insurers would no longer be permitted to properly price the risk they pose.

Once again, this assertion is supported by the data. The Arkansas Insurance Department released a study on the use of credit in July 2007. The study found that, for those personal lines companies that considered credit information, **auto insurance policyholders who saw a premium decrease outnumbered those who saw an increase by a ratio of 3.35 to 1.** In fact, 89.9 percent of auto insurance consumers either received a discount or saw no effect on their premiums. Due to Connecticut’s demographics, we expect that even more consumers benefit from the use of credit information than in Arkansas and would be forced to pay higher premiums under this bill.

TERRITORIAL RATING

Insurance prices are first and foremost a function of claims and their costs. The amount paid by policyholders is based on a number of underlying factors that influence the likelihood of claims and the average cost of claims. Characteristics reflecting the geographical location of a driver’s residence are among the most effective variables for determining auto insurance loss expectancy. Some characteristics contributing to varying loss potential among different areas are traffic density, health care and body shop repair costs, claiming behavior, attorney involvement, the level of exposure to uninsured drivers, motor vehicle theft rates and fraud.

In order to have equitable insurance premiums throughout a state, dissimilarities in the driving environment must be recognized. The price paid should be commensurate with the risk being exchanged; in other words, rates for a particular area should not be influenced by loss experience reflecting other areas. The higher the insured costs, the higher should be the insurance premium. Since losses incurred by city dwellers are generally higher than in rural and suburban communities, the premiums paid by insured drivers living in urban areas should be higher than their counterparts in other areas.

Restrictions should not be placed on the use of geographical location in the rating process. Free market forces should be allowed to regulate territorial rates to ensure the most efficient flow of services to all insured drivers. Under Connecticut's current "75-25" rule, 75 percent of rates for any territory must be based on its own claims experience and 25 percent must be based on the statewide average claims experience. **No other state in the nation requires that insurance prices be set using a mandated distribution of territorial and state losses.**

The use of both territorial and state claims experience creates a shift in costs so that drivers residing in higher-risk areas pay lower prices than what their true levels of risk reflect. For many years, lower-risk drivers in Connecticut have had to pay inflated and unfair rates to subsidize those drivers living in higher-risk areas. Specifically, the "75-25" rule has resulted in rate decreases given to drivers in more urbanized areas, averaging from an estimated 0.1 percent (Norwalk) to 11.3 percent (Hartford City) less than their true rates. To offset these unwarranted reductions, more than 60 percent of the insured drivers in the state have been imposed average premium increases ranging from about 0.4 percent (the less populated areas of New Haven County) to 5.6 percent (e.g., Middlesex, Tolland, and Windham Counties, etc.).

If the "75-25" rule were changed to a "50-50" rule, costs would be compounded even more for lower-risk drivers. **On average, 61 out of 100 insured drivers in the entire state would have an additional increase ranging from 0.4 percent to 5.3 percent (or an average of 3.3 percent) in their full coverage (liability and physical damage) rates.** Those living in Hartford County (excluding Hartford city and its suburbs and New Britain), who comprise 12 percent of the state's insured population, would have to pay about 4.9 percent more to offset the extra 12.8 percent discounts given to the larger city/suburban motorists in their county. Residents of the more suburban and rural areas of Middlesex, Tolland, and Windham Counties and parts of Litchfield and New London Counties, who represent more than one out of five insured drivers in the state, would have even greater increases of 5.3 percent. Other areas that would be negatively impacted by the adoption of a 50-50 rule are Westport, Darien, Greenwich, New London, Norwich, Torrington, Suburban Waterbury and the less populated areas of Fairfield County.

In contrast, 39 out of 100 insured drivers would have an additional decrease ranging from 0.1 percent to 12.8 percent (or an average of 4.5 percent) in their full coverage rates under a "50-50" rule. These drivers live in the more densely populated cities and towns of Hartford, Bridgeport, New Haven, New Britain, Waterbury and Stamford. Those in Hartford and Bridgeport, whose respective rates would be 12.8 percent and 10.4 percent lower than what their true risk indicates, would stand to gain the most if a "50-50" rule passed. Drivers living in the suburbs of Hartford and New Haven, as well as Fairfield, Stratford and Norwalk, would also benefit with extra rate discounts up to 2.2 percent.

The current "75-25" rule now allows drivers in the more urbanized areas of Connecticut to pay 4.3 percent less overall than their fair share of losses. The majority of drivers in the rural and suburban areas are subsidizing their urban counterparts by paying 3.4 percent more overall. The proposed "50-50" rule would result in an even higher imposition on the majority of drivers who are the lower risks.

Today's auto insurance prices are already inadequate in the more urban parts of Connecticut due to the "75-25" rule. Not only have constraints placed on territorial rating created an inequitable redistribution of prices by forcing subsidies for some policyholders at the expense of the majority, but companies may be further discouraged to operate in certain areas, causing a shift in the marketplace and reduced competition.

In conclusion, the use of geographical location or territory as a rating criterion has been found to explain the majority of the insurance risk and is a practical method of allocating costs among policyholders. This indicator is objective, clear and unequivocal, and based upon statistically supported data that show a wide variation in insurance losses among different regions. In order to remain in a competitive market, insurers should be allowed to base their premiums on the true costs and fully use those rating tools which best evaluate the risks presented by their customers. All drivers in Connecticut should be allowed to pay equitable insurance prices and have a wide selection of coverages and products available to them.

Estimated Impact of Territorial Rating Restrictions			
(1) Territory	(2) Present 75-25 Rule: % Diff. From True Rate	(3) Proposed 50-50 Rule: Additional % Diff. From True Rate	(4) = (2) x (3) Overall Impact: % Differential from True Rate
Hartford	-11.3%	-12.8%	-22.7%
Bridgeport	-9.4%	-10.4%	-18.8%
New Haven	-7.5%	-8.2%	-15.1%
New Britain	-5.8%	-6.2%	-11.6%
Waterbury	-4.1%	-4.2%	-8.1%
Stamford	-3.2%	-3.3%	-6.4%
Suburban Hartford	-2.2%	-2.2%	-4.4%
Fairfield and Stratford	-1.1%	-1.2%	-2.3%
Suburban New Haven	-1.0%	-1.0%	-2.0%
Norwalk	-0.1%	-0.1%	-0.3%
Above-Average Risks	-4.3%	-4.5%	-8.5%
New Haven County Balance	+0.4%	+0.4%	+0.8%
Westport	+1.0%	+1.0%	+2.1%
Fairfield County Balance	+1.5%	+1.5%	+2.9%
Darien and Greenwich	+2.8%	+2.8%	+5.7%
New London, Norwich and Torrington	+3.9%	+3.7%	+7.7%
Suburban Waterbury	+4.0%	+3.8%	+8.0%
Hartford County Balance	+5.1%	+4.9%	+10.2%
Remainder of State	+5.6%	+5.3%	+11.2%
Below-Average Risks	+3.4%	+3.3%	+6.8%
<p><i>Notes: (a) The above percentages reflect bodily injury and property damage liability, uninsured and underinsured motorists, and the most commonly bought Comprehensive and Collision coverages.</i></p> <p><i>(b) Column (2) represents the current rate differentials off the true risk under the "75-25" rule. Column (3) represents the additional rate differentials off the true risk under a "50-50" rule; these percentages are the resulting rate increases and decreases if a new "50-50" rule is adopted. Column (4) percentages represent the overall differentials off the true risk under a "50-50" rule.</i></p>			
Source: PCI Compilation of Auto Experience			